(34)

No. 05-130

IN THE

Supreme Court of the United States

EBAY INC.,

Petitioner,

v.

MERCEXCHANGE, L.L.C.,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF FOR TECHNOLOGY PATENTS & LICENSING, INC., EXPANSE NETWORKS, INC., AND CHARLES A. ELDERING AS AMICI CURIAE SUPPORTING RESPONDENT

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INTEREST OF AMICI CURIAE[1]

Amici are entities whose businesses are based on the management of intellectual property, and in particular patents. *Amici* believe that strong patent rights, and in particular certainty in the enforcement of those rights, are essential to maintain the appropriate incentives for innovation. *Amici* also believe that maintaining those rights is crucial for the efficient operation of markets in the global economy, in which the developers of intellectual property and the manufacturers of products are very frequently different entities. *Amici* believe the well-established presumption in favor of permanent injunctive relief to implement a final judgment of infringement is essential to the ability of patent holders to enforce their patents. Petitioner seeks to alter dramatically the established system and replace it with a system that would significantly reduce the ability of holders of United States patents to maintain technological leadership.

Amicus Technology, Patents & Licensing, Inc. provides patent analysis, development and acquisition services to clients ranging from publicly traded multinationals to startups and sole inventors.

Amicus Expansē Networks, Inc. develops computer based system solutions, and previously monetized its intellectual property in the field of targeted advertising through the sale of a patent portfolio of issued and pending patents in that field.

Amicus Dr. Charles A. Eldering is an engineer, inventor, entrepreneur, and patent professional, with more than 20 issued and 40 pending United States patents. Dr. Eldering is the founder and president of both Technology, Patents & Licensing, Inc. and Expanse Networks, Inc.

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1. In accordance with Supreme Court Rule 37.6, *Amici* state that this brief was authored in its entirety by the counsel listed herein. No person or entity other than *Amici* listed on the cover made a monetary contribution to the preparation or submission of this brief. A blanket consent to the filing of amicus briefs in support of either party has been filed with the Clerk of the Court by Petitioner and Respondent.

SUMMARY OF ARGUMENT

For over 150 years, the rule in patent cases has been that when a plaintiff shows that a defendant has infringed a valid patent, an injunction should issue as a matter of course in the absence of special circumstances. This Court and the Federal Circuit have upheld this rule over and over in the face of repeated and diverse attacks and arguments, correctly pointing out that it is for Congress, not the courts, to define the remedial system that best implements inventors' constitutional rights to exclude others from using their innovations for a limited time. The rule is not a "per se" or "automatic" injunction rule, but is consistent with the requirements of Section 283 of the Patent Act, requiring courts to apply principles of equity in these cases. In most cases those principles will favor injunction, and it is rarely necessary to examine each equitable factor explicitly. The default presumption—that irreparable harm exists and legal remedies are an insufficient substitute for the express statutory grant of the right to exclude others—gives the correct result in the vast majority of cases and creates certainty and predictability that are required to support innovation. In the rare case where some externality (such as an effect on public health) requires an exception, infringers can appeal to principles of equity and, if successful, avoid an injunction and continue infringing without cost, so long as equity requires it.

The stable and predictable enforcement environment provided by these rules has created markets that could not otherwise exist. These include not only markets for inventions, but also markets for the underlying intellectual property rights associated with those inventions. Potential infringers use well-understood economic models, including game theory, to weigh the consequences of a contemplated infringement, and the current system provides a deterrent to infringement that is priced into those models. Adding new burdens or additional layers of proof to patent enforcement creates uncertainty and removes that deterrent, the market effect of which is to reduce greatly the value of intellectual property rights, some of which

investors have already paid millions of dollars to acquire and protect.

In addition, the burden of this uncertainty falls disproportionately on the most important inventions. New technologies can be classified as "disruptive" or "sustaining" and "incremental" or "breakthrough". Disruptive, breakthrough technologies are those that fundamentally change the way people work in or think about the areas in which they arrive. These innovations, however, are especially difficult to value as markets for them typically do not exist at the time they appear. Business models based on these innovations may be unconventional, and rational inventors may determine that the most efficient course of action is neither to produce nor to license these innovations until a more mature market emerges. The courts are ill-equipped to determine, in these cases, what legal damages might constitute adequate compensation, what precisely constitutes an "irreparable" harm or whether the innovator's chosen business model is entitled to protection under more traditional equitable analysis. Instead the courts must assume that the patent holder is rational and, by enforcing the right to exclude, permit the market to value the invention. The rule in *Continental Bag Co. v. Eastern Bag Co.*, 210 U.S. 405 (1908) has accomplished this for nearly a century of growing innovation. This Court should reaffirm it and uphold the Federal Circuit's decision.

ARGUMENT

I. The Rule Applied By The Federal Circuit Is Not A *Per Se* Rule, But A Rule Crafted To Create Economically Necessary Certainty While Recognizing The District Courts' Discretion To Grant Or Deny Permanent Injunctions

A. The Federal Circuit Has Consistently Recognized District Courts' Discretion To Grant Or Deny Permanent Injunctions

The United States Constitution authorizes Congress "To promote the Progress of . . . useful Arts, by securing for limited Times to . . . Inventors the exclusive Right to their . . .

Discoveries." U.S. CONST. art. I, § 8, cl. 8. Congress, in exercising this authority, has determined that "exclusivity" means more than merely the right to collect damages for infringement, and so it has authorized the district courts to "grant injunctions in accordance with the principles of equity to prevent the violation of any right secured by patent, on such terms as the court deems reasonable." 35 U.S.C. § 283.

Petitioners argue that the Federal Circuit has done away with Section 283 in its injunction analysis in favor of a *per se* rule that strips the district courts of discretion in applying that statute. Petition at 2. Petitioners are mistaken. As the Federal Circuit has made it clear in this case, and in all of its earlier jurisprudence on this subject, "that district courts, as befits a question of equity, enjoy considerable discretion in determining whether the facts of a situation require it to issue an injunction." *Odetics, Inc. v. Storage Tech. Corp.*, 185 F.3d 1259, 1272 (Fed. Cir. 1999).

The Federal Circuit's statement that patentees are *normally* entitled to a permanent injunction once infringement and validity have been established is fully consistent with Section 283 and with the traditional, four factor test approved by the Court in determining the propriety of granting injunctive relief. The BRIEF OF AMERICAN INTELLECTUAL PROPERTY LAW ASSOCIATION AND FEDERAL CIRCUIT BAR ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF NEITHER PARTY filed herein on January 17, 2006 (the "AIPLA/FCBA Brief") treats this subject in greater detail, and *Amici* join in and adopt Section I thereof including the authorities cited therein.

B. The Rule Applied By The Federal Circuit In This Case Applies Traditional Equitable Principles, But Appropriately Recognizes That Certain Factors Will Generally Favor Injunction

In contexts outside of patent law, this Court has identified four equitable factors relating to the injunction analysis: (1) whether plaintiff would face irreparable injury absent an injunction, (2) whether plaintiff has an adequate remedy at law,

(3) whether granting the injunction is in the public interest, and (4) whether the balance of hardships tips in plaintiff's favor. *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 312 (1982). The Federal Circuit has not disposed of this injunction analysis, but rather has acknowledged (implicitly, if not explicitly) that when infringement has been established, these four factors will typically favor injunction.

First, Congress has determined that a patent confers upon its owner "the right to exclude others" from making, using or selling the covered invention for a limited term. 35 U.S.C. § 154(a)(1)-(2). The Federal Circuit has pointed out that "[t]he very nature of the patent right is the right to exclude others." *Smith Int'l, Inc. v. Hughes Tool Co.*, 718 F.2d 1573, 1581 (Fed. Cir. 1983). Thus, where validity and continuing infringement have been established, "immediate irreparable harm is *presumed*." *Id.* (emphasis supplied). Contrary to Petitioners' argument, the Federal Circuit has not, either in this case or in its past jurisprudence, eliminated the "irreparable harm" element of the injunction analysis. It has merely determined, correctly, that the fundamental right to exclude granted to patent-holders by Congress for a limited term (which term in not tolled during infringement) supports a presumption that infringement causes irreparable injury.

Second, a final determination of validity and infringement establishes the inadequacy of the legal remedy, just as it establishes irreparable harm. The Constitutional grant of exclusivity, taken up explicitly by Congress in the statute, clearly establishes that the right to recover money damages cannot adequately take the place of the right to exclude—the two rights are fundamentally different, and both Congress and the Founding Fathers elected to grant patent owners *both* rights for the limited time during which patent protection is available. The Federal Circuit explicitly examined this element of the traditional test, and here found that the patentee's willingness to license its patents did not rebut its presumptive right to injunctive relief. *MercExchange, L.L.C. v. eBay, Inc.*, 401 F.3d 1323, 1339 (Fed.

Cir. 2005). As set out in detail in the AIPLA/FCBA Brief (Section II(B) and cases cited) this holding is not only consistent with the long line of Federal Circuit precedent, but is also the rule in trademark and copyright cases.

Third, in considering the "public interest" factor, the injunction analysis favors the patentee because, as the Court has noted "the patent system represents a carefully crafted bargain that encourages both the creation and the public disclosure of new and useful advances in technology, in return for an exclusive monopoly for a limited period of time." *Pfaff v. Wells Elecs., Inc.*, 525 U.S. 55, 63 (1998) (quoting *Bonito Boats Inc. v. Thunder Craft Boats Inc.*, 489 U.S. 141, 150-51 (1989)). The maintenance of that balance must be foremost in the public interest analysis and thus, as the Federal Circuit has noted, it may be presumed that in most cases public policy will favor an injunction as that is the remedy Congress provided. *Smith*, 718 F.2d at 1578 ("Without the right to obtain an injunction, the right to exclude granted to the patentee would have only a fraction of the value it was intended to have, and would no longer be as great an incentive to engage in the toils of scientific and technological research."). This is not to say this initial presumption cannot be rebutted, however, and the substantial public interest in maintaining this balance thus can be outweighed, for example, when the "patentee's failure to practice the patented invention frustrates an important public need for the invention, such as the need to use an invention to protect public health." *MercExchange*, 401 F.3d at 1338 (internal quotation omitted). In this case, however, the Federal Circuit correctly found, that no such concerns sufficient to outweigh the presumption could be found.

Fourth, the final element of the injunction analysis compares the hardship the patentee would suffer absent an injunction with the burden the injunction would impose on the infringer. This element is rarely at issue in patent cases, as an adjudged infringer rarely takes the position that infringement should be excused because of the hardship it would face if forced

to cease its unlawful conduct. When infringers do make such arguments, the evidence of harm they present is often speculative or—as here—contradicted by their own public statements. *MercExchange, L.L.C. v. eBay, Inc.*, 275 F. Supp.2d 695, 714 (E.D. Va. 2003), *rev'd*, 401 F.3d 1323 (Fed. Cir. 2005) (Petitioners have stated that "they can design around the patents with relative ease".). While the Petitioner argued below, and apparently argues here, that the "hardship" arising out of the need for judicial administration of an injunction should weigh in its favor, the Federal Circuit correctly recognized that the burden of judicial administration is insufficient to tilt the balance as it is not a hardship to the defendant. *MercExchange*, 401 F.3d at 1339.

A more detailed explanation and analysis of *Amici's* arguments on the foregoing four elements, and additional authorities supporting *Amici's* position, are set out in Sections II(A) through II(D) of the AIPLA/FCBA Brief. *Amici* hereby join in and adopt those Sections of the AIPLA/FCBA brief and the authorities set out therein.

C. The Recognition That Certain Factors Generally Favor Injunction Adds Certainty To The Patent Enforcement Process And Permits Markets, Rather Than Courts, To Determine Appropriate Values For Innovation

Perhaps the most important benefit of the system of presumptions laid out above is that it provides certainty and predictability to the markets that have arisen not only around particular inventions, but around the business of innovation itself. Those who invent and those who fund invention require a predictable system of protection—including predictable remedies—to allow them to determine whether the enormous investments of time and money they may be making are worthwhile. Uncertainty in this process, injected by the potential application of an ill-defined standard by an ill-informed lower court, is the enemy of invention. The injunction is the primary deterrent against infringers, and is the basis by which the patent holder can keep others from violating their rights.

Justice Breyer, in his concurrence last term in *MGM Studios* described the dangers of ill-defined standards (in the copyright context) and their chilling effects on innovation:

> To require defendants to provide, for example, detailed evidence—say business plans, profitability estimates, projected technological modifications, and so forth—would doubtless make life easier for copyrightholder plaintiffs. But it would simultaneously increase the legal uncertainty that surrounds the creation or development of a new technology capable of being put to infringing uses. Inventors and entrepreneurs (in the garage, the dorm room, the corporate lab, or the boardroom) would have to fear (and in many cases endure) costly and extensive trials when they create, produce, or distribute the sort of information technology that can be used for copyright infringement. They would often be left guessing as to how a court, upon later review of the product and its uses, would decide when necessarily rough estimates amounted to sufficient evidence. They would have no way to predict how courts would weigh the respective values of infringing and noninfringing uses; determine the efficiency and advisability of technological changes; or assess a product's potential future markets . . . The additional risk and uncertainty would mean a consequent additional chill of technological development.

MGM Studios, Inc. v. Grokster, Ltd., 545 U. S. __, 125 S. Ct. 2764, 2793 (2005). In *MGM Studios*, Justice Breyer was discussing the potential chilling effect that uncertainty arising out of a nebulous or ill-defined standard for contributory infringement might have on potential inventors. Precisely the same concerns are involved here.

As set out below, creators of breakthrough inventions—inventions for which there is no present market or for which the market is in its infancy—are particularly hard-pressed to come up with a traditional analysis of irreparable harm or

sufficiency of legal remedies. To force such patent holders into the traditional equity showings required for an injunction without the benefit of the presumptions traditionally afforded by this Court and the Federal Circuit would provide the same "additional risk and uncertainty" and "consequent additional chill of technological development" so accurately forecast by Justice Breyer. The present system, on the other hand, provides a set of clear, easily applied rules with limited and well-defined exceptions. As a result, patent holders who have prevailed in litigation are generally granted the relief provided for them by Congress, but in those cases where traditional equitable concerns—such as the public welfare—require exceptions, infringers are permitted to continue their infringing conduct *without any cost whatsoever*. The system creates traditional market incentives and allows the participants, rather than the courts to determine the value of innovation.

II. For Over 150 Years, The Presumption Of Injunctive Relief Has Provided Inventors And Investors A Predictable Basis On Which To Make Balanced Economic Decisions

A. The Rule Applied By The Federal Circuit Is Not New And Is A Part Of The Expectations Of Inventors And Investors

The Federal Circuit's application in this case of the rule that an injunction will normally issue upon a finding of infringement of a valid patent is not new. For a century and a half, inventors and investors have relied on the expectation that injunctions will generally be available to protect patent rights. The exceptions to that rule are also well-known, well-defined and have become a part of the inventor's decision to disclose his invention and the investor's decision to support it. These expectations are based in large part on over one hundred years of consistent prior decisions of this Court (including its decision in *Continental Paper Bag Co. v. Eastern Paper Bag Co.*, 210 U.S. 405 (1908) at issue here), the Federal Circuit and other

Circuit Courts prior to the Federal Circuit's founding. Well-developed markets have evolved based on these expectations for both the inventions themselves and for the rights underlying them.

Section III of the AIPLA/FCBA Brief contains a more detailed analysis of the foregoing argument, including authorities in support thereof dating back to 1837. *Amici* hereby join in and adopt Section III of the AIPLA/FCBA Brief and the authorities set out therein.

B. The Exclusionary Right Recognized By This Court And The Federal Circuit Permits Investors And Patent Holders To Maximize Profits And Monetize Their Inventions According To Business Plans and Objectives

Congress has at its disposal the tools for creating compulsory licensing systems, and in some areas of intellectual property it has chosen to do so. *See, e.g.*, 17 U.S.C. § 115 (compulsory copyright licenses for phonorecords). In the patent area, however, as this Court has noted, it has refused to do so even where a patent holder chooses not to exploit its invention. *Hartford-Empire Co. v. United States*, 323 U.S. 386, 433 (1945) ("Congress has repeatedly been asked, and has refused, to change the statutory policy by imposing a forfeiture or by a provision for compulsory licensing if the patent is not used within a specified time."). Instead, Congress has chosen to permit the market—rather than the courts or some regulatory body—to determine the value of a given innovation. It has done this by explicitly permitting the patentee to exclude others from making or selling its invention, thus permitting the patentee to earn profits as it sees fit, either by licensing its rights, manufacturing under the patent and excluding others, or any combination of those and other strategies. This system works because it is built on a fundamental notion of economics: that in most circumstances market participants are better situated to evaluate inventions than outsiders.

Thus, in the simplest case, the patentee may choose to manufacture products based on the patented invention and use its exclusionary rights to prevent others from doing so, thereby maintaining, for the limited life of the patent, a manufacturing monopoly. Under these circumstances the patentee can, assuming sufficient knowledge of the elasticity of demand for the product and marginal costs, produce and price the appropriate quantity of patented products to maximize profits. If the patentee has miscalculated—perhaps due to an unknown or newly developed non-infringing substitute—the market's reaction will act as an input to pricing, causing the patentee to adopt a more optimal pricing and production structure. Use of the exclusionary right to achieve optimal results (both for the patent holder and for consumers) through licensing is well understood and described in the economic literature. *See* John W. Schlicher, LICENSING INTELLECTUAL PROPERTY: LEGAL, BUSINESS AND MARKET DYNAMICS 20-23 (1996).

In other instances, the patent holder will determine that the profits available through licensing the patent, either exclusively or otherwise, will exceed those available through manufacturing the invention itself. In these instances it is economically favorable for the patent holder to license the invention rather than manufacture it. Again, assuming the patent holder is attempting to maximize profits, this decision should be based on a determination of the most efficient manufacturer and thus should reduce costs to consumers.

There may be any number of reasons that an inventor or patent holder may not be the most efficient manufacturer (or user) of the patented innovation. For example, an individual inventor or small business may lack capital, access to manufacturing facilities, marketing resources or distribution channels to produce and sell the patented product or process efficiently. Even if there are no such barriers to entry, a small inventor may not be the most efficient choice to "productize" a particular innovation, particularly if the invention is an improvement on an existing invention that may itself be

protected. In other cases, even a large manufacturer may determine, for reasons related to sunk costs in existing manufacturing processes, that it is economically disadvantageous to produce under the patent.[2]

Regardless of the size of the entity, other reasons may exist which make it economically unfavorable for the patent owner to manufacture under the patent: manufacturing under the patent may not fit the time horizon of the patent owner's business plan, which make dictate a later entry into the market; the patent owner may use a substitute technologies that offers economically favorable manufacturing opportunities; or the patent owner may be unable to take advantage of limit pricing strategies[3] or benefit from the network externalities available to a larger manufacturer.[4] Each of these is an economically justifiable

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2. The Court correctly recognized these concerns in *Continental Paper Bag Company*, noting the patent holder's reasonable decision that it would "make more money with the existing old reciprocating Lorenz & Honiss machines and the existing old complicated Stilwell machines than could be made with new Liddell machines, when the cost of building the latter was taken into account." 210 U.S. at 428. As set out herein, *Amici* respectfully submit that the Court's decision in that case was correct and should not be modified.

3. Limit pricing strategies involve pricing a product below the monopoly profit-maximizing price (but above the competitive price) and producing a quantity greater than that at which marginal revenue equals marginal cost so as to deter entry by fringe competitors. *See* Sharon M. Oster, MODERN COMPETITIVE ANALYSIS 288-92 (1999).

4. "Network externality has been defined as a change in the benefit, or surplus, that an agent derives from a good when the number of other agents consuming the same kind of good changes." S. J. Liebowitz & Stephen E. Margolis, NETWORK EXTERNALITIES (EFFECTS) (2006), *at* http://www.utdallas.edu/~liebowit/palgrave/network.html. For example, a patentee of a feature related to a computer operating system or microprocessor may not be able to successfully manufacture or distribute a product with that feature—in spite of the feature having substantial economic value to customers—if the feature needs to be integrated into an existing operating system or hardware device which has been adopted by the vast majority of users.

reason for a patent owner to choose licensing over manufacturing as a business model. Because that choice is based on the patent owner's informed and self-interested determination of the most efficient supplier, it will provide the invention to consumers in the market at the optimal price—that is, the price that optimally balances the constitutionally mandated, time-limited patent "monopoly" with the consumer's right to partake in the invention.

In any of these cases the patent holder may be considered a "non-manufacturing entity" with respect to the patented invention, even though it may be a dominant player or leading manufacturer in the same market. As described above, however, and notwithstanding Petitioner's claims to the contrary, there is nothing inherently economically suspect about non-manufacturing patent owners. In fact, the rise of non-manufacturing entities that maintain control of intellectual property without manufacturing the patented products is well accepted in today's knowledge economy. This sector is so fundamental to the modern economy that it is important to consider it separately from the markets for the inventions themselves. There exists, of course, a market for inventions—new drugs, improved computer software and hardware, innovative financial products and a host of other inventions and substantial improvements to existing products and services. The market for these innovations is, at some stage, typically a consumer market: the end users are typically public consumers who will buy products or services based on the patented inventions.

There is also, however, a related market for the rights underlying these innovations. It includes companies that buy and sell patent rights, as well as companies, such as *Amici*, that service that market by researching, analyzing, evaluating and aiding in the marketing, licensing and protection of those rights. This, too, is a well-developed market, but it is not a consumer market—it is composed primarily of highly sophisticated participants who understand with great precision not only the

inventions covered by the patents in which they trade, but also the patent laws themselves and the rights conferred by them. The participants in these markets have made and continue to make multi-million dollar decisions based on the long-standing understanding of the precise balance offered by the patent laws and the remedies they entail. Any change in that balance will have an effect not only on the incentives to invent, but also on the value of existing portfolios of intellectual property held and traded by the participants in this secondary market.

The Federal Circuit's current rule, and the rule under *Continental Paper Bag*, properly establishes the incentives necessary to facilitate these markets while maintaining principles of equity. Increasing the burden on a patent owner seeking an injunction would disrupt that system. For example, if the Court disposes of the current rule of presumptive irreparable injury and inadequacy of legal remedy once infringement and validity are proved, the patent owner is placed in the untenable position of "fortune teller". The patent owner placed in such a position would have to come forward with a developed business plan based either on licensing or manufacturing—complete with assumptions, risks, and returns—to meet the additional burden. But the exclusionary right associated with the patent is designed precisely to avoid this requirement of looking into the future; it sets up a system by which the market provides this information during negotiations rather than forcing the participants to make *ex ante* determinations of what a potential licensee might pay.

Thus, under the patent system as Congress has currently designed it, the inherent nature of the patent as representative of a new and useful idea requires that the patentee be able to exclude others—without the need to show how use of the idea by the infringer will affect their business plan—simply upon the showing that the patent is valid and infringed.

C. Litigation Seeking Injunctive Relief Is Not A Windfall; It Carries With It Appropriate Risks And Rewards.

Much of the current debate over the injunction rules, including the arguments set out by some other *Amici* in this case, centers on the idea that an injunction granted to a patent owner represents a market failure—that it is a tool for "hold ups". This idea is false for a number of reasons, but one fundamental misapprehension underlying it is the assumption that the right to an injunction provides the patent holder with instantaneous monetization or the ability to reap rewards greater than which they would be entitled to under a royalty based damages calculation.

In fact, when the patent holder elects to pursue costly litigation (thereby seeking injunctive relief in lieu of a settlement for cash, a royalty or both) it takes very substantial additional risks that do not always result in a favorable outcome. In raising the stakes, the patent holder forces the infringer further to consider other options, including designing around the patent and attacking the validity of the patent through reexamination. During the course of the litigation (and any settlement discussions that may have taken place) both parties will have considered these options and their potential costs. But upon a finding of infringement of a valid patent, the defendant facing a substantial business disruption may determine that it is economically viable to change its product to avoid infringement, or to undertake the cost of a further challenge at the Patent & Trademark Office (the "PTO"), with the attendant risk that the patent survives such further scrutiny and emerges strengthened. In the event that an infringer chooses not to license and instead designs a work-around that is either better, cheaper or more readily licensed by others, the value of the patent will be substantially lessened and the patent holder's gamble will not only have failed to pay off, it will have backfired.

There is no basis for assuming, nor has Petitioner demonstrated, that there is any fundamental market failure

attendant upon the grant of injunctive relief in patent cases, and in fact the economic literature is to the contrary. *E.g.*, Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2657 (1994) For policy purposes at least, one must assume that infringers and inventors alike are rational actors operating to maximize profit. Infringers—on notice of their potential infringement either from the patent holder or from their own research—look at the overall economics of the situation and determine that it is more efficient to infringe than to license. In this case, Respondent has noted that the royalty awarded by the district court for past infringement, even if carried forward, would be a tiny fraction of the funds eBay has earned (for example in its stock offerings) by its use of the invention. The decision to infringe was thus, for eBay, perfectly economically sound absent an injunction.

But eBay's analysis, we must assume, did not stop there. Its decision to infringe must be examined as a cost-benefit analysis that included the potential cost of losing an infringement litigation. That cost, under the present rules, must have assumed that the result of such a loss would be an injunction. The cost of that injunction to eBay is something only eBay can calculate, because it is not necessarily the cost of taking a post-litigation license from MercExchange. It may be that cost, or the cost of researching and developing a work-around, or the cost of cross-licensing a technology from another source, or the cost of pursing a reexamination or any combination of these and a host of other potential escape routes. The infringer itself is in the best position to evaluate these outcomes and the predictability of the injunction allows it to do so. Business and their lawyers now use complex economic models based on game theory to evaluate risk and as an aid in making decisions during the course of a litigation. *See* Reiko Aoki & Jin-Li Hu, *A Cooperative Game Approach to Patent Litigation, Settlement, and Allocation of Legal Costs* (1999), *at* http://yoda.eco.auckland.ac.nz/~raoki/personal/papers/Nashjan99.pdf; J. Steven Baughman, *The Impact of Non-Traditional Patent Litigation on Cost/Benefit Analysis* (2003), *at* http://library.findlaw.com/2003/Jun/24/

132826.html. The injunction provides the only efficient deterrent to the infringer, forcing it to internalize the market value of the invention in the course of its calculations. A change to the present system would make infringers more likely to ignore this potential cost, especially if it increases the probability that a court will fail to enter and enforce an injunction.

The presumptive right to an injunction associated with the patent can thus be used by the patent holder to "test" the market, but with not without associated risks. The current system properly enforces the right to exclude others from using the patented invention by making injunctions the rule in most cases of infringement, but it does not automatically provide for the ability to monetize patent rights. Once the injunction issues, it is up to the marketplace to determine the true value of the patent or to provide more efficient solutions within the context the inventor's patent monopoly. The current system is consistent with well established principals of risk and reward in a free marketplace, creates incentives to innovate beyond current patented solutions, and rewards those who seek to protect their innovations, provided those patented innovations can withstand design around attacks. Placing an additional burden of proof on the patent holder seeking an injunction forces the court to act as the marketplace, something is ill-equipped to do.

III. This Court's Holding In *Continental Paper Bag* And The Rule Applied By The Federal Circuit Represent A Balance Of Rights That Provides Certainty And Enhances The Market For Innovation

A. Innovations Can Be "Sustaining" Or "Disruptive"; Though The Value Of Disruptive Innovation May Be Great, It Is Difficult To Foresee

Inventions can usefully be classified according to two parameters, one relating to the degree of "disruption" of the invention, the other related to the breadth or scope of the invention. The degree of disruption of an invention can be characterized as ranging from "sustaining" innovation to "disruptive" innovation, and breadth can be characterized as

ranging from "incremental" to "breakthrough". As has been described by Clayton M. Christensen in his book, *The Innovator's Dilemma*,[5] sustaining technologies foster improved product performance and maintain the general nature of the product. As such, sustaining innovation can be viewed as the improvement of existing technology.

Disruptive technologies, on the other hand, can result in worse product performance as compared to existing products, but address a need of the marketplace, frequently in a drastically new way. Disruptive innovation can thus be embodied in inventions which support "a new way of thinking" or which "change the paradigm" in a given area. For example, notebook computers can be considered to be an established technology, with improvements in battery life and screen brightness being classified as sustaining innovation, whereas hand-held digital appliances, and systems and methods for allowing them to perform specialized functions—all of which can be performed on notebook computers—can be considered disruptive innovation with respect to notebook computers. The hand-held devices, while having performance and functionality that is clearly inferior to a powerful notebook computer, satisfy a marketplace need and contain features to which consumers ascribe value.

In both sustaining and disruptive innovation, the invention may be incremental or breakthrough. An incremental, sustaining innovation would be a small, but important improvement to an existing technology, process or product. Incremental, disruptive innovation refers to a small but innovative invention that forms a part of, or supports, a disruptive technology. Breakthrough innovation refers to inventions that encompass an entirely new approach to solving a problem associated with either a sustaining or disruptive technology. For example, the invention of the microprocessor[6] itself could be considered to be a breakthrough, with subsequent innovations that improved speed and

5. Clayton M. Christensen, THE INNOVATOR'S DILEMMA (2003).

6. *See* US Patent Nos. 3,821,715 and 3,753,011.

performance being incremental inventions. The advent of hand-held digital appliances included breakthrough inventions in that field, followed by numerous incremental inventions.

Inventors and entrepreneurs, by their basic nature, are largely driven to find a "radical" new way of doing things and are thus more likely to develop a disruptive technology than a sustaining technology. In the high technology industry, startups typically are not given financing to develop an incrementally better microprocessor or computing platform, or to develop a slightly improved content storage device; rather, investors seek inventors who can envision and develop a "revolutionary" product or service. The small, entrepreneurial inventor is thus often in the position of developing a product or service that has no current market. It may be comparable to an existing market—in the same way that the automobile market was once comparable to the horse and buggy market—but if the invention is, like the automobile, truly disruptive, then such comparisons may not be particularly useful in determining whether the costs of pursuing innovation will eventually be out weighed by the returns. In other words, because markets for disruptive technologies cannot necessarily be readily ascertained ("markets that don't exist can't be analyzed"[7]) it may not be possible, *ex ante*, to determine the economic value of a patent which covers a disruptive technology, or to establish a reasonable royalty rate for the patent. As an example, as noted by Christensen, forecasts of sales of disruptive disk drive technologies were completely wrong whereas forecasts for sustaining drive technologies were very accurate.[8] Given the inability to predict the market size and acceptance for a technology covered by a particular patent covering a disruptive technology, it is virtually impossible to determine a present value for it.

Thus, the inventor in this position, and the venture capitalist or other investor choosing to support the inventor, must make certain assumptions. Foremost among these is the assumption

7. Christensen, *supra* note 7, at xxv-xxvi.

8. *Id.* at 166-68.

that, if and when a patentable innovation emerges from the inventor's work and the investor's capital, the patent will have the bundle of rights normally associated with property—including, perhaps most importantly, the right to exclude others for a period long enough to develop the market. Because of the inherent uncertainty attendant to disruptive innovation, inventors with patents to disruptive technologies will frequently choose to exclude others from manufacturing products covered by the patented technology until the marketplace evolves sufficiently to price and adopt the disruptive technology. The patent holder in such a case cannot establish traditional notions of irreparable harm or insufficiency of damages because there is no existing market to use as a baseline. Additional burdens of proof in this context thus punish the truly innovative inventor and result in decreased access to capital for such inventors and a strong disincentive for them, particularly small businesses and solo inventors, to disclose their disruptive innovations as part of the patent bargain.

B. The Creators Of Disruptive Innovations Are Often Non-Manufacturing Entities Or, As Here, Entities Unable To Sustain A Manufacturing Business At The Time Of the Innovation

Innovators associated with small businesses are statistically more prolific inventors, and are inventors of patents that, when measured by the number of citations, are likely to be more fundamental. According to U.S. Government statistics, small businesses produce 13 to 14 times more patents per employee than large patenting firms and these patents are twice as likely as large firm patents to be among the one percent most cited. UNITED STATES SMALL BUSINESS ASSOCIATION, OFFICE OF ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2005), *at* http://www.sba.gov/advo/stats/sbfaq.pdf. American innovation is taking place in small businesses. The small businesses and individual inventors that hold patents are much more likely to be non-manufacturing entities then large corporate patent holders, given that they are frequently early-stage companies or entities that lack easy access to capital.

Given that these smaller inventors—the very ones that create important innovations—are unlikely to have the means to productize, manufacture and market them, it is critical to ensure that they can anticipate full enforcement of their exclusive rights. It is precisely the full enforcement of those exclusive rights that allows the inventor to use those rights for access to capital to allow production, or to effectively license those rights to larger manufacturing entities. Here, the remedy and the right are one and the same: to enforce the right to exclude, the inventor must be entitled to prohibit use by others, even if a fully-developed marketplace does not yet exist for the invention or the small inventor is not yet a direct participant in the marketplace. Under these circumstances, a traditional analysis of irreparable harm and adequacy of legal remedies may be impossible, but the right must still exist. Failure to provide adequate remedies to enforce these rights will severely undermine inventors' ability and motivation to develop the valuable innovative technologies and will also chill investment in those innovations due to additional uncertainty.

C. Courts Are Particularly Ill-Suited To Valuing Disruptive Innovation On A Prospective Basis, Whereas Efficient, Well-Developed Markets Exist To Do So For Both The Inventions And The Patents Protecting Them

The role of patents as business tools is well understood. Companies and inventors use patent rights to establish economically favorable relationships with competitors, vendors, and even customers, and those relationships are often the cornerstone of modern businesses. Although reports vary widely as to the actual dollar amount associated with patent licensing, it is generally acknowledged that patent licensing is a multi-billion dollar industry. Kamil Idris, INTELLECTUAL PROPERTY: A POWER TOOL FOR ECONOMIC GROWTH 7 (WIPO 2003), *at* http://www.wipo.int/freepublications/en/intproperty/888/wipo_pub_888_1.pdf ("PricewaterhouseCoopers in 1999 found that the global IP licensing market totaled more than US$100 billion".). In addition to cross-licensing and the value, as measured

in actual cash payments between licensees and licensors associated with that cross-licensing, there is an active market for patents themselves, which are being sold in private and public transactions with increasing frequency.[9] *See* Don Clark, *Inventors See Promise in Large-Scale Public Patent Auctions*, WALL STREET J., March 6, 2006, at B1. This market—the developing market for patent rights themselves rather than the inventions they describe—is perhaps the purest possible expression of the ideas underlying Congress's patent system.

This thriving market in intellectual property owes its existence to the fact that patent rights are like property: freely transmissible and alienable and backed up with well-understood, predictable legal remedies sufficient to give them real value. Of course, sophisticated market participants may disagree as to the value of a given innovation, the scope of a given patent or even the patent's chances in litigation. Those differences of opinion are what make markets possible, but the market is not served by uncertainty as to *remedies*. If a patent is found to be valid and infringed, investors and inventors alike must have certainty that they will be able to exclude the infringer from continued use—the addition of new burdens of proof in that area frustrates expectations both prospectively and, importantly, retrospectively for those market participants who have already invested (often millions of dollars) in existing patents.

Valuation of patents, especially patents covering disruptive technologies, is complex even for sophisticated market participants. Although numerous techniques exist for valuing patents,[10] and entire businesses exist to do so—including *Amici's*—the final determination of the fair market value of a

9. For example, current Internet resources trading in such rights include: *Ocean Tomo: Intellectual Capital Equity*, *at* http://www.oceantomo.com/auctions.html; *Free Patent Auction: Where Inventions Are Sold*, *at* http://www.freepatentauction.com/; *IP Auctions: The Intellectual Property Marketplace*, *at* http://www.ipauctions.com/; *IP-Trader*, *at* http://www.ip-trader.com/; *Patent Show*, *at* http://www.patentauction.com/.

10. *See, e.g.*, Richard Razgaitis, EARLY STAGE TECHNOLOGIES 73-86 (1999).

patent is simply the price at which the patent is transferred between a willing buyer and a willing seller, each having reasonable knowledge of all pertinent facts and being under no obligation to buy or sell. Studies of patent value suggest, along with valuation methods based on cost of patent application preparation and filing,[11] that, based on replacement cost, the mean value of a patent in the marketplace[12] is approximately $10,000 to $12,000, with a small percentage of patents having marketplace values of hundreds of thousands of dollars, and an even smaller percentage having values of millions, tens of millions or even hundreds of millions of dollars. This is consistent with *Amici's* experience in reviewing tens of thousands of patents for potential purchase. Although *Amici* are not aware of statistics on the value the marketplace puts on patents, it is clear that there is a robust market for patents, as evidenced by the sale and auctioning of patents held by companies including Motorola, Ford, and Clorox.[13] It is also *Amici's* experience that the marketplace is becoming particularly adept at locating patents that may have exceptional value and that may represent disruptive technologies that are beginning to be adopted by the marketplace. In these instances values of hundreds of thousands or even millions of dollars can be, and are, ascribed to those patents. The fact that large manufacturing entities would agree to sell patents, and that other entities will purchase them for cross-licensing and licensing purposes, is indicative of a healthy, open marketplace in which technology rights can be sold, bought and put to use by the appropriate manufacturing or non-manufacturing entities.

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11. Cost of filing is one valuation methodology. *Id* at 33-40. Average filing costs are tabulated annually and published by the American Intellectual Property Association, AIPLA REPORT OF THE ECONOMIC SURVEY (2005).

12. Gideon Parchomovsky & R. Polk Wagner, *Patent Portfolios*, U. PENN. LAW SCHOOL, SCHOLARSHIP AT PENN LAW, PAPER 51 at A5, *at* http://lsr.nellco.org/upenn/wps/papers/51.

13. *See* OCEAN TOMO SPRING 2006 LIVE PATENT AUCTION OFFERING CATALOG (2006), *at* http://www.oceantomo.com/auctions.html.

Congress has acknowledged that the marketplace is more efficient at ascribing values to patents than are lawmakers or the courts. It is not the role of the courts to become a compulsory licensing body simply because an inventor or patent holder has made an economic decision to exclude others from producing an invention—even where the patent holder itself opts not to produce it. Congress and the courts have long made the assumption that patent holders are (generally speaking) rational, profit-maximizing actors. If that it the case, as noted above, the patent injunction provides no "unfair advantage" to the patent holder. Eventually, assuming the invention has value to the public, the patent holder and enjoined infringer will reach licensing terms that provide the benefits of the invention to the public while at the same time justly compensating the patent holder for the invention. If they do not, the market will provide a non-infringing solution and the patent holder will get nothing. Assuming that the invention genuinely has value to the public and the patent is valid and survives litigation and additional PTO review, one of those two outcomes *must* result, and the public should be indifferent as to which of the two wins out in the end.

The recent, well-publicized litigation between Research In Motion (makers of the Blackberry email device) and NTP has served to illustrate this point. Despite the protestations of the infringer and the public outcry regarding the possible loss of a valuable service, the market participants reached an economic agreement: one in which the patent holder reaped a financial reward and the infringer was allowed to continue to operate. *Amici* find it particularly interesting to note that, despite cries of "hold-up" in the mainstream press, the increase in market capitalization due to the settlement of the litigation more than made up for the payment to the patent holder.[14]

14. According to data reported at Yahoo! Finance, RIM has approximately 185.2 million shares outstanding. Its closing price on Friday March 3, 2006 was $71.92; the case settled after the close of trading for a payment of $612.5 million and trading opened on Monday

(Cont'd)

This was the Court's holding in *Continental Paper Bag* and *Amici* respectfully submit that holding was, and remains, correct. It has been the basis for nearly a century of decisions and analyses by inventors and investors and it should not be disturbed. The courts are ill-suited to playing the role of the market forecasters in determining the value of patents, especially those involving disruptive technology or developing markets; under these circumstances a court may, in all good faith, mistakenly assign a royalty rate that discounts or ignores the strategic value of the patent as the marketplace evolves. Only a willing buyer—fully informed of the patent, risks associated with the patent, and the marketplace—is able to place a dollar value on that patent and the rights associated with it.[15]

D. Adding Uncertainty To The 150 Year-Old Rules Of Patent Remedies Will Frustrate Expectations And Destroy Value In The Underlying Markets For Both Inventions And The Patents Themselves

The long standing rules of patent remedies have, for 150 years, maintained the value in patents by providing the patent holder with the right to exclude others from use of the invention when the patent is upheld as valid and infringed. Adding additional burdens of proof, balancing tests, or otherwise requiring a more explicit vetting of equitable factors will add

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March 6, 2006 at $81.14. RIM's market cap thus increased over $1.7 billion on news of its $612.5 million payment.

15. The use of the term "dollar value" here also glosses over another important limitation facing courts. If the court has any power at all to craft a prospective legal remedy for infringement (which is open to some question) it is certain that such a remedy would be limited to money damages. Often, however, money is not the only important term in technology licensing transactions. Courts are particularly ill-suited to crafting and enforcing complex licensing regimes that may include unique provisions such as sub-licensing rights, derivative works rights, technical support, use limitations, cross-licenses, payment schedules, most-favored-nation provisions, indemnification clauses and a host of other provisions.

substantial uncertainty to patent remedies. Adding such uncertainty has the fundamental, economic effect of radically devaluing patent rights and destabilizing the market for those rights.

As noted above, the addition of a complex layer of proof (as opposed to the current system of rebuttable presumptions) between the finding of infringement and validity and the application of a remedy for that finding can only add uncertainty to the patent process. If the Court today abandons its position in *Continental Paper Bag* and lays out new requirements for successful patent plaintiffs seeking injunctive relief, the lower courts will have to interpret that guidance which, as a practical matter, will create tremendous uncertainty. The very high rates of reversal by the Federal Circuit indicate that the lower courts simply are not well-suited to patent analysis; adding more such analysis will only compound the problem. The added uncertainty and potentially decreased chance of obtaining an injunction will greatly decrease the deterrent incentive that infringers currently face, and will encourage infringement and litigation associated with those infringements.

These issues become even more serious if the Court bases any new position on an analysis of the patent holder's business model or the type of patent at issue: for example, a new standard applicable only to non-manufacturing entities or "business model" patents. Such distinctions can be very difficult to draw, and in some cases are not static. If the Court announces a new standard applicable only to non-manufacturing entities, are the lower courts to retain jurisdiction over every patent case, so that injunctive relief can be revisited each time the patent rights change hands from a non-manufacturing entity to a potential manufacturer? What standards are the lower courts to use in determining whether, in the face of a complex cross-licensing deal, the real parties in interest are manufacturing entities or not? What if plaintiff is a manufacturing entity, but does not manufacture products in the field of the patents at issue? What precisely defines a "business model" patent—does a complex

financial model fall into that category? Does the software used to implement that model belong in that category? Courts have traditionally avoided this kind of categorization precisely because they are not equipped for it. If it becomes a part of the patent relief analysis it can only add uncertainty to a market that requires well established and predictable enforcement rights.

With over 1,900,000 utility patents currently in force,[16] erosion of the patent rights through modification of the present injunction rule would cause a substantial decrease in the value of existing patent portfolios. Not only would the average value of patents decrease—a decrease of only 10% on an average value of $12,000 per patent resulting in a loss of over $2 billion in value—but patents covering breakthrough technologies would be significantly undermined. It is extremely difficult to quantify how great the loss in value to existing patent portfolios might be if the Court were to substantially increase the burdens on patent holders seeking injunctions for their valid and infringed patents, but in *Amici's* experience that diminution could be as much as fifty percent. Clearly, such an erosion of value would work an enormous hardship on one of the most important and growing sectors of the American economy: the market for intellectual property rights.

IV. This Court Should Not Attempt To Remedy Perceived Issues Of Patent Quality By Introducing Further Uncertainty At The Remedy Stage

As the Court is aware, perceived issues of patent quality currently plague the U.S. patent system. Petitioner, and some *Amici* herein (in particular *Amici* Yahoo! and the Computer & Communications Industry Association), have suggested that patent quality is suffering due to an inability of the PTO to locate the most relevant prior art and to make appropriate determinations with respect to obviousness. The economic motivations of the PTO itself have also been called into question

16. This is based on approximately 2.4 million issued patents that are within term, of which approximately 500,000 are not active due to failure to pay maintenance fees or intentional abandonment.

due to, *inter alia*, examiner incentives to allow applications and fee-funding issues that may arise if liberal allowances are seen to encourage additional filing. *Amici* have also cited reports and other literature which they believe detail a multitude of other problems causing and surrounding patent quality.

It is beyond dispute that the PTO is currently overwhelmed. With pendency times for patents approaching four years in some technology areas,[17] there is no doubt that the PTO needs help in dealing with the increasing number of inventions being presented to it. The increasing number of applications is only to be expected as a result of the tremendous sharing of information now being provided by the Internet. This sharing should fundamentally improve the amount and quality of innovation, and it is not—as some might suggest—something to be afraid of. But this undeniable strain on PTO resources and its effect, if any, on patent quality cannot be addressed through modifications to patent remedies. Such efforts can only have the effect of "throwing out the baby with the bathwater" by diluting the rights of "good" patents along with those which may be of "questionable" quality. In fact, the perverse result of attempting to address patent quality at the remedies stage is that the patents that have survived the crucible of litigation over validity and infringement—those patents that are most likely to be "good" patents—would be weakened by the additional burdens aimed at the class of patents to which they have just demonstrated they do not belong.

Furthermore, requiring a patent holder to address these burdens at the remedy stage—to establish irreparable injury and inadequacy of legal remedy—would in most cases require a detailed examination of the merits of the invention in the marketplace. Thus, the patent plaintiff who has just survived (and paid for) a searching validity analysis including questions of obviousness and market utility, would be forced to address

17. USPTO 2005 PERFORMANCE AND ACCOUNTABILITY REPORT 4, 22-23 (2005), *at* http://www.uspto.gov/web/offices/eom/annual/2005/2005annualreport.pdf.

precisely those questions *once again* in seeking a remedy. The infringer, in the meantime, would be gaining to a second bite at the apple (presumably before a judge this time) having already lost on these issues before the jury.

In short, addressing actual or perceived patent quality issues by introducing uncertainties into remedies simply cannot work. Attempting to "fix" a regulatory or property scheme by increasing the legal burden on the purportedly stronger party cannot be effective in the long term. As Judge Posner has written in the context of contractual interpretation:

> The idea that favoring one side or the other in a class of contract disputes can redistribute wealth is one of the most persistent illusions of judicial power. It comes from failing to consider the full consequences of legal decisions. Courts deciding contract cases cannot durably shift the balance of advantages to the weaker side of the market; they can only make contracts more costly to that side in the future, because franchisors will demand compensation for bearing onerous terms.

Original Great American Chocolate Chip Cookie Co., Inc. v. River Valley Cookies, Ltd., 970 F.2d 273, 282 (7th Cir. 1992). The same principle applies here: any effort to "make up for" perceived imbalances in the patent system by increasing the burdens on patent holders seeking injunctions will eventually be worked out by the marketplace in the form of higher costs for innovation. As Judge Posner put it, in the end "everyone will pay for the loss of legal certainty that ensues when legal principles are bent however futilely to redistributive ends." *Id.*

Patent quality issues are currently addressed through existing mechanisms in the courts and at the PTO. Although the plaintiff in a patent infringement suit has the benefit of the presumption of validity of the patent, that validity is challenged extensively during the course of litigation. In addition, the defendant can force the patent into reexamination, requiring the PTO to look at the matter anew with additional references. Modification of the criteria for injunctive relief cannot, and

should not, provide the basis for a new mechanism for testing the validity of issued patents. Cases relating to obviousness and other indicia of validity have come before this Court in the past and will soon do so again. If Congress will not deal with issues of patent quality, such cases give the Court ample opportunity to do so, but attempting to fix such a problem by addressing a general remedy will only increase uncertainty and exacerbate the existing issues.

CONCLUSION

The judgment of the court of appeals should be affirmed, and the Court should not disturb its decision in *Continental Paper Bag Co.* v. *Eastern Paper Bag Co.*, 210 U.S. 405 (1908) or the general rule that, in the usual case, injunctive relief is appropriate where infringement and validity of a patent have been proved.

Respectfully submitted,

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